

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

DIRECT ROUTE, LLC, a Washington
LLC,

Plaintiff,

v.

ONOFFLINE, Inc., a Washington
corporation, d/b/a ADVENTONLINE, and
FERNANDO AZNAR, an individual,

Defendants.

CASE NO. C09-1509MJP

FINDINGS OF FACT AND
CONCLUSIONS OF LAW
REGARDING DEFENDANTS'
MOTION FOR SANCTIONS

This matter comes before the Court on the motion for sanctions filed by Defendants OnOffline, Inc. and Fernando Aznar. (Dkt. No. 53). The Court first reviewed the motion, Plaintiff's opposition (Dkt. No. 56), Defendants' reply (Dkt. No. 60), and related filings (Dkt. Nos. 54, 55, 57, 58, 59, and 61.) Upon determination that an evidentiary hearing was necessary, the Court reviewed the supplemental briefing provided by the parties (Dkt. Nos. 84, 93, 96, and 98), and all related filings (Dkt. Nos. 85, 86, 87, 88, 89, 90, 91, 92, 94, 95, 97, 99, 100, 101, 102,

1 106, 107, 108, 109, and 113). The Court held a four-day evidentiary hearing on December 10-11
2 and 17-18, 2012.

3 Upon consideration of all the evidence, and after hearing the oral arguments of the
4 parties, the Court DENIES Defendants' motion. In reaching this determination, the Court makes
5 the following findings of fact and conclusions of law:

6 **Findings of Fact**

7 1. Plaintiff Direct Route is a Washington LLC located in Tukwila, Washington. Defendant
8 OnOffline is a Washington corporation with its principal place of business in Seattle,
9 Washington. Defendant Fernando Aznar is the CEO of OnOffline.

10 2. Plaintiff Direct Route and Defendant OnOffline are competitors in the field of providing
11 mailing services to bulk email customers. These services are primarily used to send unsolicited
12 email, or "spam."

13 3. On January 26, 2007 Defendant OnOffline entered into a licensing agreement with
14 Plaintiff Direct Route allowing Defendant to use Plaintiff's routing software.

15 4. Defendant OnOffline terminated the agreement in April 2007. OnOffline began using its
16 own software, which it marketed to other customers under the name "Routebee."

17 5. In the summer of 2007, Plaintiff's CEO, Brent Biggs, began to suspect that Direct
18 Route's routing software was being copied after finding evidence that his source code was posted
19 on a Russian Internet site.

20 6. When Plaintiff Direct Route installed its software on Defendant OnOffline's server, it
21 included a "backdoor node" that allowed it to access Defendant's server. Defendant was unaware
22 this node was installed and did not authorize it.

1 7. In early July 2007, Biggs used the undisclosed backdoor node to break in to Defendant
2 OnOffline's server and view files and directories associated with OnOffline's routing software.
3 OnOffline never authorized this access.

4 8. On July 12, 2007, Mr. Biggs asked OnOffline CEO Fernando Aznar to meet him at a
5 restaurant. At the restaurant, Mr. Biggs confronted Mr. Aznar with screenshots containing
6 software code, and accused OnOffline of stealing Direct Route's software.

7 9. In addition to using the backdoor node to investigate his suspicions, Plaintiff's CEO
8 Brent Biggs also engaged in clandestinely tape recording phone conversations with third parties
9 to gather evidence about alleged misappropriation of Plaintiff's software code.

10 10. In June 2008, Plaintiff Direct Route hired Badgley Mullins Law Group to work with its
11 existing counsel John Ladenburg to explore the potential infringement of Direct Route's
12 intellectual property.

13 11. On December 18, 2008, Plaintiff Direct Route received U.S. Patent No. 7,467,229 ("the
14 '229 Patent"). The '229 Patent encompasses a networking system that includes configuration of
15 servers to route network addresses to a router through a networking tunnel. The router is then
16 configured to route the network address through a recipient server. One purpose of the software
17 is to allow bulk email service providers to ensure receipt of their messages.

18 12. There is not sufficient evidence to find that Plaintiff filed the application for the '229
19 Patent more than one year after the product was sold or offered for sale and the invention was
20 ready for patenting.

21 13. In July 2009, Plaintiff Direct Route, through its counsel, hired Dr. Daniel Grossman, a
22 professor in the Department of Computer Science & Engineering at the University of
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1 Washington, to independently analyze Defendant OnOffline's source code for copyright
2 infringement and patent infringement.

3 14. Dr. Grossman analyzed the OnOffline source code and determined that it infringed the
4 '229 Patent. He prepared a claim chart showing every element of the claimed invention is found
5 in Defendant OnOffline's code.

6 15. In September 2009, Plaintiff sent Defendant a letter alleging willful infringement of the
7 '229 Patent, asserting it was entitled to a royalty and treble damages, plus fees and costs.

8 16. Plaintiff also sent threatening letters to Defendant's customers, causing Defendant's
9 revenues to drop sharply.

10 17. Plaintiff has engaged in a pattern of sending strongly worded demand letters to its former
11 customers, as well as to their customers. These letters demanded quick settlements and
12 threatened litigation if the recipients continue to use competitors' software.

13 18. Plaintiff filed the present suit against Defendants OnOffline and Fernando Aznar in
14 October 2009, alleging patent infringement, breach of contract, violation of Washington's
15 Uniform Trade Secret Act, conversion, and unjust enrichment.

16 19. Shortly after Plaintiff Direct Route filed suit, Defendant OnOffline sought ex parte
17 review of the '229 Patent.

18 20. The Court stayed the litigation pending reexamination. OnOffline's first ex parte request
19 for reexamination was initially denied, but that decision was reversed and the proceeding was
20 ultimately merged with the inter partes reexamination.

21 21. On October 25, 2011, the U.S. Patent and Trademark Office determined that each of the
22 eight claims under the '229 Patent was rejected on multiple bases. Direct Route did not appeal,
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1 and the '229 Patent has been cancelled. This Court then dismissed Plaintiff's patent claim, and
 2 declined to exercise jurisdiction over the remaining state law claims.

3 **Conclusions of Law**

4 **A. Legal Standard**

5 Title 35 U.S.C. § 285 provides that the Court "in exceptional cases may award reasonable
 6 attorney fees to the prevailing party." 35 U.S.C. § 285. Here, the parties agree that Defendants
 7 qualify as the prevailing party for the purpose of this motion. (Dkt. No. 84 at 7.) The
 8 determination of whether a case is exceptional under § 285 is a two-step process. Wedgetail, Ltd.
 9 v. Huddleston Deluxe, Inc., 576 F.3d 1302, 1304 (Fed. Cir. 2009). First the district court must
 10 establish by clear and convincing evidence that the case is exceptional. Cambridge Prods., Ltd. v.
 11 Penn Nutrients, Inc., 962 F.2d 1048, 1050 (Fed. Cir. 1992). Then, the court must exercise
 12 discretion in determining whether an award of fees is appropriate in the circumstances. Cybor
 13 Corp. v. FAS Techs., Inc., 138 F.3d 1448, 1460 (Fed. Cir. 1998).

14 The Federal Circuit has explained that a case is "exceptional" "when there has been some
 15 material inappropriate conduct related to the matter in litigation, such as willful infringement,
 16 fraud or inequitable conduct in procuring the patent, misconduct during litigation, vexatious or
 17 unjustified litigation, conduct that violates Fed. R. Civ. P. 11, or like infractions." Brooks
 18 Furniture Mfg., Inc. v. Dutailier Int'l, Inc., 393 F.3d 1378, 1381 (Fed. Cir. 2005). Because the
 19 right to bring and defend litigation implicates crucial First Amendment rights, the Federal Circuit
 20 has held that "absent misconduct during patent prosecution or litigation, sanctions may be
 21 imposed against a plaintiff only if both (1) the litigation is brought in subjective bad faith, and
 22 (2) the litigation is objectively baseless." iLOR, LLC v. Google, Inc., 631 F.3d 1372, 1377 (Fed.
 23 Cir. 2011) (citations omitted).

1 B. Subjective Bad Faith

2 Defendants present evidence that Plaintiff has engaged in unscrupulous business
 3 practices, but they do not meet their burden of showing by clear and convincing evidence that the
 4 present litigation was brought in subjective bad faith. See iLOR, 631 F.3d at 1377. A claim is
 5 brought in subjective bad faith if the objective unreasonableness of the claim was either known
 6 or so obvious that it should have been known by the patentee. Highmark, Inc. v. Allcare Health
 7 Mgmt. Sys., 687 F.3d 1300, 1313 (Fed. Cir. 2012) (citations omitted). To show that litigation
 8 was brought in subjective bad faith, a party must do more than show “a patentee’s bad-faith
 9 business conduct toward an accused infringer prior to litigation.” Forest Labs. v. Abbott Labs.,
 10 339 F.3d 1324, 1329 (Fed. Cir. 2003). The Federal Circuit explains that subjective bad faith
 11 litigation requires showing “vexatious, unjustified, or frivolous litigation.” Id. at 1330.

12 First, Defendants fail to show that Plaintiff knew it was in violation of the PTO’s one-
 13 year on-sale bar when it filed suit.¹ Defendants allege Plaintiff violated the provision barring
 14 issuance of a patent if the application is filed more than one year after the product was sold or
 15 offered for sale and the invention is ready for patenting. (Dkt. No. 98 at 2); 35 U.S.C. § 102(b).
 16 Defendants also allege that Plaintiff’s principal, Brent Biggs, “knew that the pre-critical-date use
 17 of and offers to sell the ‘Direct Route’ technology were material to the patentability of the ‘229
 18 Patent, and knowingly acted to avoid disclosure of such information to the PTO.” (Id.)
 19 Defendants conclude, therefore, that “[i]n light of Direct Route’s knowledge of its invalidating
 20 activities, the only explanation is that Direct Route sued OnOffline on the ‘229 Patent in bad

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 22 ¹ Defendants explicitly stated in their motion for sanctions that they do not allege misconduct during patent
 23 prosecution or litigation. (Dkt. No. 53 at 8.) The Court accepted this representation and limited the scope of the
 24 evidentiary hearing accordingly. (Dkt. No. 62.) During the evidentiary hearing, Defendants’ counsel explained that
 evidence relating to Plaintiff’s alleged violation of the one-year on-sale bar was meant to demonstrate that the
 litigation was brought in subjective bad faith and that it was objectively baseless, not as evidence of misconduct
 before the PTO.

1 faith.” (Dkt. No. 93 at 5.) This allegation does not constitute clear and convincing evidence. See
2 Cambridge Prods., 962 F.2d at 1050. Even if Plaintiff did violate the one-year on-sale bar,
3 Defendant fails to point to any evidence that Plaintiff was aware it was in violation of the bar.
4 (Dkt. No. 98 at 2.) All Defendants show is that Plaintiff’s counsel knew that a one-year bar
5 existed in patent law, not that Plaintiff was in violation. (Id.) Without more, this does not show
6 bad faith.

7 Next, the fact that Plaintiff broke into OnOffline’s server and stole its source code does
8 not show that the present litigation was brought in subjective bad faith. Defendants allege that
9 this break-in was “a desperate attempt to thwart OnOffline’s development efforts.” (Dkt. No. 53
10 at 2.) Defendants do not allege that Plaintiff orchestrated the break-in to lay the groundwork for a
11 baseless suit. (Id.) In fact, Plaintiff’s behavior, while despicable and possibly in violation of the
12 Computer Fraud and Abuse Act, 18 U.S.C. § 1030, is consistent with that of a company that
13 sincerely believes its intellectual property is being infringed. See Brooks, 393 F.3d at 1384
14 (“enforcement of patent rights that are reasonably believed to be infringed does not entail special
15 penalty when the patentee is unsuccessful”).

16 Plaintiff’s efforts to extract a settlement from Defendants also do not show that the
17 present suit was brought in subjective bad faith. In his declaration supporting the present motion,
18 OnOffline CEO Aznar states that, immediately before filing the complaint in this case, Direct
19 Route served a demand letter encouraging settlement. (Dkt. No. 55 at 1.) On the date the case
20 was filed, Direct Route again emailed OnOffline’s counsel and suggested the parties engage in
21 settlement discussions. (Dkt. No. 54 at 1-2.) Defendants also charge that Plaintiff made extreme
22 settlement demands, and has also engaged in similar strong-arm behavior against other
23 defendants and third parties. (Dkt. No. 53 at 2-3.) But Plaintiff’s conduct in other suits does not
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1 prove that it brought the present litigation in bad faith. See Brooks, 393 F.3d at 1384 (conduct
 2 with respect to other competitors does not support district court's conclusion that plaintiff acted
 3 in bad faith in asserting its patent). More importantly, each of these demands is consistent with
 4 that of a company that reasonably believes its patent is being infringed. See id. (the fact that
 5 plaintiff has sued others and is unwilling to grant a license is not indicative of bad faith). Plaintiff
 6 may have been rude and overly aggressive, but this does not prove bad faith.

7 Finally, evidence that Plaintiff conducted a reasonable pre-filing investigation weighs
 8 against finding that the present suit was brought in subjective bad faith. Plaintiff asserts that it
 9 engaged counsel in June 2008 to explore potential infringement, and also hired Dr. Daniel
 10 Grossman, a professor in the Department of Computer Science & Engineering at the University
 11 of Washington, to independently analyze Defendant's source code for potential patent
 12 infringement. (Dkt No. 84 at 4.) Although Defendants allege that "Direct Route's own
 13 employees knew, before the suit was filed, that the invention at issue was based on standard
 14 network architecture," Defendants do not prove that this is true. (Dkt. No. 98 at 5.) In the
 15 absence of persuasive evidence that Plaintiff's pre-filing investigation was inadequate,
 16 Defendants do not show by clear and convincing evidence that Plaintiffs filed this suit in
 17 subjective bad faith.

18 C. Objectively Baseless Litigation

19 Defendants also fail to show by clear and convincing evidence that the present litigation
 20 is objectively baseless. See iLOR, 631 F.3d at 1377. "To be objectively baseless, the
 21 infringement allegations must be such that no reasonable litigant could reasonably expect success
 22 on the merits." Dominant Semiconductors Sdn. Bhd. v. OSRAM GmbH, 524 F.3d 1254, 1260
 23 (Fed. Cir. 2008) (citations omitted). Where the infringer prevails in the underlying action, factors
 24 relevant to the inquiry of objective baselessness include the closeness of the question, pre-filing

1 investigation, discussions with the defendant, and litigation behavior. Serio-US Indus., Inc. v.
2 Plastic Recovery Techs. Corp., 459 F.3d 1311, 1322 (Fed. Cir. 2006). Importantly, the
3 requirement that the litigation be objectively baseless “does not depend on the state of mind of
4 the [party] at the time the action was commenced, but rather requires an objective assessment of
5 the merits.” Brooks, 393 F.3d at 1382.

6 The strongest evidence that this litigation may have been objectively baseless comes from
7 the PTO’s sweeping rejection of all claims under the ‘229 Patent on multiple, independent
8 grounds. (Dkt. No. 93 at 7.) Explaining the PTO action, Defendants assert that, “at the time
9 Direct Route filed the ‘229 Patent application, and indeed long before, a person of skill in the art
10 would have been well aware of routing technology and methods, including the method claimed
11 under the ‘229 Patent, to encapsulate, route, and tunnel IP addresses across multiple VLANs
12 (virtual local area networks).” (Id. at 9.) Defendants argue the claims under the ‘229 Patent were
13 based on open source code, simply automated a known manual process, and were a response to a
14 design need or market pressure. (Id.)

15 However, Plaintiff presents evidence that it could reasonably have been unaware of the
16 LARTC reference, which the PTO used to invalidate the ‘229 Patent. (Dkt. No. 84 at 8.) Plaintiff
17 explains, “Prior to the issuance of the ‘229 Patent, Direct Route’s patent attorney and the PTO
18 Examiner collectively performed three prior art searches, none of which uncovered the LARTC
19 reference.” (Id.) Plaintiff’s expert, Dr. Grossman, also stated that he was not familiar with the
20 prior art, calling it “obscure,” and saying he “was impressed with whoever found it.” (Id.) The
21 evidence and argument of the parties do not provide a clear answer as to whether Plaintiff’s suit
22 was objectively baseless. The burden of proof is therefore determinative. See Q-Pharma, Inc. v.
23 Andrew Jergens Co., 360 F.3d 1295, 1303 (Fed. Cir. 2004). In a request for attorney’s fees under
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§ 285, “the underlying improper conduct and the characterization of the case as exceptional must be established by clear and convincing evidence.” Brooks, 393 F.3d at 1382. Defendants fail to establish by clear and convincing evidence that the present litigation was objectively baseless. Id.

Conclusion

While the Court cannot condone Plaintiff’s behavior, and a ruling in Plaintiff’s favor should not be viewed as approval of Plaintiff’s conduct, the standard to be applied in this matter is stringent. Defendants have failed to show by clear and convincing evidence that the present litigation was brought in subjective bad faith and was objectively baseless. Therefore, this case is not exceptional under § 285. The Court DENIES Defendants’ motion for sanctions.

The clerk is ordered to provide copies of this order to all counsel.

Dated this 10th day of January, 2013.



Marsha J. Pechman
United States District Judge